PENDER

CORPORATE BOND FUND

THE MANAGER'S MONTHLY COMMENTARY – NOVEMBER 2019

The Pender Corporate Bond Fund returned -0.5% in November, the somewhat lower unit value resulting from lower marks in several distressed or wide-spread credit lines.

We hold a portion of the Fund in distressed credits because, over reasonable time horizons, this area has demonstrated delivery of very attractive returns. However, distressed debt can be volatile, and we have seen some weakness here in November. We saw drawdowns in McDermott International term loans and bonds as that company continues to work through its out-of-court debt restructuring. Frontier Communications, where a distressed exchange or Chapter 11 filing is anticipated was also weak. In addition, Dean Foods filed for Chapter 11 restructuring and, in that case, we exited our position on a small post-filing bounce as we felt our weight in this category was better deployed elsewhere. On a positive note, we did receive a cash disbursement from the Aceto liquidation amounting to 88% of face value. Our expectation in that case is a return of full par, plus accrued value, for a nice gain versus our 57% of face value cost.

Offsetting a portion of the November weakness was our position in Avadel Pharmaceutical convertibles, which rallied more than 15% on progress in its drug development pipeline. Element Fleet preferred shares also rallied on the assignment of an investment grade rating to that issuer which had formerly been junk-rated. Carbonite, Inc. convertible notes improved on a bid for the company that implies a 107 takeout of our position recently acquired at a cost of 94% of face value. Finally, recently added Teva Pharmaceuticals bonds also rose more than 5% in value on relief regarding a settlement of some opioid legal claims.

What's Left to Go Up? Building Blocks for 2020 Credit Returns

Credit markets in 2019 have generally been a "Tale of Two Cities," with the apparent fireproof houses of highly rated issuers (including even the BB rated High Yield issuers) rolling on to successive price highs with their spreads and rates ratcheting ever lower. But for all the popping of champagne corks in "Bidsville," down the road in "Ask-a-toon" neglected and unpopular credits have languished, sometimes plunging perilously in the face of an unwillingness of investors to refinance maturing debt. While Bonds rated "BB" began the year at 3.7% spread over treasuries and have compressed down to 2.2%, the opposite end of the credit spectrum has actually widened. "CCC" and below issuer spreads have recently pressed to new highs of 11.4% over Treasuries.

In the past twenty years, the relative yield advantage of bonds rated CCC and below, in comparison to BB rated credits, has only exceeded the current ratio of 3.1x for a few months. And that period, which was late 2015 and early 2016, immediately preceded an excellent return for this Fund and high yield credit generally. In an industry that lives by the trader's maxim, "the trend is your friend," it is not always easy to abandon comfortable momentum for the as yet unfulfilled promise of theoretical value. Yet, as the latter part of 2019 has unfolded, that indeed has been our program. As December commences, we look to a number of "stone cold" and "dirt cheap" sectors to drive portfolio returns through 2020. These include:

Pharma and Biotech: In 2014 you may recall that, once upon a time, biotech IPO's flew off the shelves like umbrellas in a Vancouver rainstorm. Back then it took little more than a labcoat and a pitchbook to raise a billion dollar round from eager investors. Five years into a disillusionment cycle, sentiment in the industry has swung to the opposite extreme. Teva Pharmaceuticals, the world's leading generic drug company, has seen its onetime $85B enterprise value slashed by as much as $50B in less than three years. Teva bonds issued at coupons of 2's and 3's some years ago now trade to yields in the high single digits. Even with its promising new antibiotic now approved and reporting growing sales each quarter, Boston-based Paratek Pharma's business is valued at less than a tenth of its late 2014 start-up EV. Paratek convertible bonds currently trade around at 62% of face value, leaving them worth less than balance sheet cash. We believe an interesting turnaround has begun in this industry and have a few positions that look fruitful for 2020.

Retail: Even those who still get news delivered by pigeon post have, at this juncture, received the memo about Amazon.com and its inevitable steamrolling of all things retail. And yet stores, in many segments of the

market, refuse to die. We are not cyber-deniers, just observers of the combination of continuing profitability and ongoing management adjustments being made by several retailers, particularly those whose products defy long-distance shipping and/or require a degree of in-store service. Rite Aid, with a stable cash earnings line, is emblematic of this group of credits. Priced at its historically minimum EV/Sales multiple, and with significant potential as an acquisition target, we like Rite Aid 2023 bonds trading to yield over 13% to maturity. Other retail credits offer similar potential.

Engineering and Construction: We realize consensus earnings forecasts aren't always reliable. However, it is still odd to see a large engineering and construction company like Tutor Perini having street estimates of over 30% for operating profit growth in 2020, while at the same time sporting valuation multiples of 6.5x estimated earnings and 0.5x book value. Bond spreads in this sector we believe are far too wide and it wouldn't take an unreasonable re-rating to drive Tutor's well-covered 2021 convertible notes into the money, given their $30 strike price. Similarly, McDermott International, an admittedly distressed issuer, has credit that is trading at a tiny look-through valuation in comparison to our estimate of private market value for this business.

Were space to permit us to elaborate further, we could also mention telecoms businesses, Canadian rate reset preferreds, and profitable oil producers and copper miners as other areas of interesting credit value. There is also a wide swath of small, growing public companies with interestingly wide credit spreads unwarranted by their improving fundamentals. We believe all these areas of the credit market will grow in popularity in 2020.

Fund Activity … "Deeper in the Cheaper" and a Couple of New Lines

This month we added weight in a number of existing holdings which showed good value. We added to our position in the 2021 0.875% convertible notes of SunPower Corp, whose cash repayment appears overwhelmingly likely in the wake of the company's recent spin-off transaction and equity raise. These notes closed November yielding almost 6% to a 2021 maturity. We also increased our weight in Tutor Perini credit as that company continues to make progress collecting long-term receivables.

We initiated a stake in the Briggs and Stratton 6.875% notes maturing in December 2020, priced to yield over 14%. Briggs and Stratton has a storied history as a manufacturer of small engines for garden machinery and similar products. While foreign competition and a delayed move into electric motors has hurt the company lately, its enduring position with key OEM's and sizeable branded product portfolio are significant assets. Technically, we see a strong path to repayment for these notes given excess senior loan capacity earmarked for that precise purpose.

Fund Positioning

The Fund yield to maturity at November 30 was 5.7% with current yield of 4.5% and average duration of maturity-based instruments of 2.8 years. There is a 2.3% weight in distressed securities purchased for workout value whose notional yield is not included in the foregoing calculation. Cash represented 6.1% of the total portfolio at November 30.

Geoff Castle
December 5, 2019

[1] *F Class*

For full standard performance information, please visit: http://www.penderfund.com/funds-and-performance